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TAGS: ECON ETRD IS ECONOMY AND FINANCE

SUBJECT: SECOND MEETING OF THE EGYPT-ISRAEL QIZ COMMITTEE

Classified By: Deputy Chief of Mission Gene A. Cretz for reasons 1.4 (b) and (d)

**11.** (C) Summary: The second meeting of the Egypt-Israel Qualifying Industrial Zones (QIZ) committee met on August 14 in Jerusalem. The GOE claimed that more than USD 61 million worth of QIZ products have been sent to the U.S. during the period under review, consisting of at least USD 8.6 million worth of Israeli inputs. The committee certified that 50 of 54 companies that exported to the U.S. during the first quarter of operation met the content requirements for QIZ qualification. In addition to the routine certification work, the Egyptians encouraged the GOI to approve a joint request to USTR for expansion of the zones. Finally, Israel noted a systemic problem with the Israeli input purchases by Egyptian manufacturers, and proposed the adoption of a table that would outline the acceptable percentage of inputs for QIZ textile products; the GOE did not agree with the request. End summary.

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The numbers  
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**12.** (C) The Egypt-Israel QIZ committee met in Jerusalem on August 14. The meeting was co-chaired by Gabby Bar (GOI) and Sayed Elbous (GOE), and attended by members of the Egyptian and Israeli Ministries of Trade, Foreign Affairs, Finance and Departments of Customs. Econoff attended as an observer. The six-hour meeting began with the certification of companies that sent exports to the U.S. during the period February 22-June 30, 2005. The committee noted:

--54 total factories sending QIZ products to the US (total value of over USD 61 million)  
--50 companies in compliance (approximately a 93% success rate for the first period of review)  
--4 companies not in compliance with the minimum Israeli content requirements  
--19 new companies approved to participate in existing QIZs

The committee approved 19 new companies located within existing QIZs for export to the U.S. from August 14, 2005-February 15, 2006; bringing the total number of Egyptian companies eligible for export to 464. (Note: Only 12% of the companies that were approved for QIZ production during the March 22, 2005 meeting in Cairo actually exported QIZ products to the U.S. during the first review period. End note.) Based on their failure to meet the 11.7% minimum Israeli content requirements, four companies, Cotton Belt Egypt (#33), American Group Bitotex International (#75), Eurotextile Co (#286), and Nazmy for Clothing & Tricot (#334) were disqualified from exporting to the U.S. under the QIZ rules from August 15-November 14, 2005. Copies of all official joint committee documents have been faxed to USTR and NEA/IPA, originals will follow.

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Transshipped QIZ inputs  
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**13.** (C) The GOI Department of Customs, Senior Chief Coordinator for rules of origin, David Houry raised the issue of Politsur, an Israeli company that was found transshipping Turkish inputs to the Egyptian QIZ companies. The GOI noted that Politsur is under legal investigation by the Department of Customs' prosecutors office. There is no evidence of malfeasance on the part of the Egyptian companies that purchased inputs from Politsur - believing them to be of Israeli origin - and the GOI has not concluded what percentage of the merchandise sent by Politsur to Egypt as QIZ input was actually transshipped. The committee decided not to disqualify companies that had purchased from Politsur during this quarter. The Egyptian delegation stated that they would "blacklist" Politsur to make sure that during the next quarter there would not be a similar problem.

**14.** (C) The GOE asked the GOI for assistance in preventing such cases of fraud in the future. Alaa Arafa, Chairman of Arafa Group and owner of one of the largest companies currently sending QIZ products to the U.S. market, stated

that Egyptian businessmen need a "whitelist" and a "blacklist" so that they will know which companies to buy from, since it was "impossible" to conduct independent checks. The GOE also proposed issuance of "official" GOI certificates of origin to help eliminate fraud. The GOI did not agree to either option, but determined that better information sharing could limit the influence of such fraudulent businessmen in the future. The committee agreed to discuss options to cut back on transshipment fraud, during the next joint committee meeting.

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Time to expand?  
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15. (C) Throughout the meeting Elbous raised the issue of expanding the size and scope of the QIZs. He indicated that the GOE is anxious to receive a reply from Israel regarding a joint request to USTR for expansion. Bar noted that although the GOI is reviewing the request, Minister of Industry, Trade, and Labor (MOITL) Ehud Olmert wanted to study the results of the August 14 meeting before making a decision to move forward with expansion. (Note: Bar told EconOff that there was no plan to file an expansion request until Olmert had met USTR Portman. With Olmert's time now split between MOITL and the Ministry of Finance, Bar was not able to project a proposed meeting time. End note.)

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Israeli Inputs  
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16. (C) After concluding the certification, the GOI passed a proposed list of input guidelines to the GOE. The GOI explained that they had noticed a significant number of Egyptian companies that were importing a single input from only one Israeli source. The GOI questioned if it was proper, given the language in the QIZ protocol that states that inputs must be "direct and relevant," to be included in meeting the 11.7% minimum Israeli content requirement. One example noted by Bar was of a company that had purchased stone wash detergent powder from an Israeli manufacturer which totaled 11.7% of the value of products shipped to the U.S. While there was no question that the purchase was made from an Israeli company, Bar indicated that analysis by the Israeli Manufacturers' Association indicated that such a quantity of stone wash detergent was enough to wash "millions of jeans pants." Bar commented that although this powder could be considered part of an Israeli input for the production of jeans, it was unreasonable to believe that such a single input (with the possible exception of fabric for textile production) could really amount to 11.7% of the value of a product. However, Bar noted that the GOI proposed the inputs list as only a guideline for Egyptian factory owners so they would know what was considered a reasonable input by the committee. In addition, Bar noted that there were no plans to apply the list retroactively to the 54 companies that had already sent products to the U.S.

17. (C) Elbous replied that such an approach was never discussed during the negotiations related to the QIZ and that what was being proposed was a drastic change to the nature of the agreement. He called into question the ability of Israel to supply inputs for the Egyptian QIZ manufacturers, and noted that there had been parliamentary inquiry over the cost of Israeli inputs. Arafa told Bar that such a drastic change in the agreement would, "kill the new baby that we have just created" and urged the GOI to "give it time."

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Prospects for the Future  
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18. (C) Comment: Both parties left the meeting dissatisfied by the failure to reach agreement over the issues of expansion of the zones and the definition of inputs. Additional negotiating sessions, either in person or via phone, are necessary to resolve these issues before the third joint committee meeting on November 15. The undertone to the GOI request for a maximum percentage list of acceptable inputs is the possibility that the GOI team will not agree to certify companies that purchase only one input from only one supplier during the next committee meeting. The draft list only includes textile inputs, but the GOI will include other products, if applicable.

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Impact on Jordan QIZs  
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19. (C) Comment continued: The Jordanian government has requested that the certification for Jordanian QIZ products be conducted on a quarterly basis parallel to the Egypt QIZ process. (Note: Products are currently certified for minimum Israeli content on an item-by-item basis for Jordanian QIZ producers. End note.) The GOI has indicated that its

willingness to move towards this approach for Jordanian producers will be based on successful implementation in the Egyptian QIZs. Based on the GOI team's view of the results of the meeting, it is doubtful that they will offer to employ the quarterly certifications for Jordanian producers in the near future. Finally, the GOE noted that it was aware of the Jordanian request to lower Israeli content to 5% of QIZ products, and that such a model seemed illogical if Egypt would still be expected to meet the 11.7% Israeli content requirement. Israeli negotiators appeared displeased that the GOE was aware of what they deemed an "informal" Jordanian request for lower Israeli content. End comment.

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